Report

of the

Examination of

WASHINGTON TOWN MUTUAL INSURANCE COMPANY

Washington Island, Wisconsin

As of December 31, 2001

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 17, 2002

Honorable Connie L. O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2001, of the affairs and financial condition of

WASHINGTON TOWN MUTUAL INSURANCE COMPANY

Washington Island, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1997 as of December 31, 1996. The current examination covered the intervening time period ending December 31, 2001, and included a review of such subsequent transactions deemed essential to complete this examination.

The Summary of Examination Results contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company in April 1889, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Mutual Home Fire Insurance Association of the Town of Washington, Door County. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there were no amendments to the articles of incorporation and no amendments to the bylaws.

A review of the certificate of authority revealed that the company is currently licensed to write business in Door County. The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for term of one year with premiums payable on the advance premium basis. Quarterly and semi-annual installments are allowed. Policy fees are not charged policyholders.

Business of the company is acquired through one agent, who is a director, and is Treasurer and Manager of the company. The agent is presently compensated for services on an hourly basis.

Losses are adjusted by two director/adjusters, who may include the agent/manager/director. Adjusters receive $25 for each loss adjusted.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of six members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Wayne Boshka	Retired	Washington Island	2005
Kirby Gunnlaugsson	Carpenter/Mason	Washington Island	2005
Marlene Mann	Grocery Store	Washington Island	2004

Ivan Johnson	Subcontractor, Sanitation	Washington Island	2004
Thomas Koyen	Carpenter/ Concrete	Washington Island	2003
Marjorie Bjarnarson	Manager, Insurance Agent	Washington Island	2003

Members of the board currently receive $15 for each meeting attended. Directors are also compensated $100 annually.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at the present time are as follows:

Name	Office	Annual Salary
Ivan Johnson	President	$150
Thomas Koyen	Vice President	100
Marlene Mann	Secretary	150
Marjorie Bjarnarson	Treasurer	150

The treasurer also received $28,292 in 2001 for services as the company's Manager and agent.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The president appoints the entire board of directors as claim adjusters and property inspectors. Also, the directors, except the treasurer, were appointed as the wage committee.

Growth of Company

The growth of the company during the past five years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
1997	$66,894	$11,321	466	$74,146	$1,277,374	$1,229,847
1998	58,607	8,868	461	72,679	1,360,849	1,306,515
1999	60,835	34,838	456	37,408	1,409,065	1,338,448
2000	71,241	5,828	450	76,137	1,481,397	1,422,348
2001	72,698	13,565	442	84,258	1,563,633	1,501,559

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Net
1997	$117,817	$64,590	$1,229,847	10%	5%
1998	128,039	58,754	1,306,515	10	4
1999	127,385	71,564	1,338,448	10	5
2000	140,446	71,274	1,422,348	10	5
2001	149,285	72,402	1,501,559	10	5

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
1997	$11,321	$41,466	$66,894	17%	64%	81%
1998	8,868	45,237	58,607	15	77	92
1999	34,838	58,276	60,835	57	81	138
2000	5,828	62,243	71,241	8	87	95
2001	13,565	54,412	72,698	19	75	94

The company has shown steady growth over the past five years, except for a decline in policies in force. The writings ratios are lower than the industry average. This can be attributed to the company limiting its premium writings exclusively to Washington Island and nearby Detroit Island, due to the cost of traveling to and from Washington Island. The expense ratio is higher than the industry average due to its island location, and because of the relatively small premium volume. The company loss ratio (except for 1999) is lower than the town mutual industry average. This is from proper underwriting, the company knowing its policyholders, and a limited amount of losses. The policies in force have declined the last four years, which the company indicated is due to competition.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty with five coverage sections. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retention of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2002
Termination provisions:	Either party may terminate this contract as of any subsequent January 1 by giving to the other party at least 90 days' advance notice in writing.

The coverages provided under this treaty are summarized as follows:

1.	Type of coverage:	Class A Casualty Quota Share
	Lines reinsured:	All business written classified as Casualty business
	Company's retention:	None
	Coverage:	100% of each and every loss, including LAE, subject to the maximum policy limits of: a. $1,000,000 per occurrence, single limit or combined for bodily injury and property damage liability. b. $1,000,000 split limits, in any combination of bodily injury and property damage liability. c. $5,000 for medical payments, per person; $25,000 per accident.
	Reinsurance premium:	100% of the premium written
	Ceding commission:	15% of the premium paid to the reinsurer
2.	Type of Coverage:	Class B First Surplus
	Lines Reinsured:	All property business
	Company's retention:	When the company's net retention is $200,000 or more in respect to a risk, the Company may cede on a pro rata basis, and the Reinsurer shall be obligated to accept up to $800,000. When the company's net retention is $200,000 or less in respect to a risk, the Company may cede on a pro rata basis, and the Reinsurer shall be obligated to accept up to 50% of such risk. Annual aggregate deductible amounts equal to 10% of the loss and LAE otherwise recoverable, unless waived.
	Coverage:	Pro rata portion of each and every loss, including LAE, corresponding to the amount of the risk ceded.

	Reinsurance Premium:	The pro rata portion of all premiums, fees and assessments charged by the Company corresponding to the amount of each risk ceded.
	Ceding Commission:	A provisional commission of 15% of the ceded premium. The minimum commission shall be increased by 1% for each 1% decrease in the loss ratio subject to a maximum commission of 35% when the loss ratio is 45% or less. Any amount above a 65% loss ratio or below a 45% loss ratio and shall be carried forward.
3.	Type of Coverage:	Class C-1 Excess of Loss First layer
	Lines Reinsured:	All property business
	Company's Retention:	Annual aggregate deductible of $10,000 and $10,000 per loss per occurrence.
	Coverage:	$65,000 excess of retention including loss adjusting expenses.
	Reinsurance Premium:	Net premium written multiplied by the sum of four year's losses incurred divided by the total net premiums written for the same period multiplied by a factor of 100/80ths. Minimum Rate: 6% of the current net written premiums. Maximum Rate: 21% of the current net premiums written.
4.	Type of Coverage:	Class C-2 Second Excess of Loss
	Lines reinsured:	All property business
	Company's retention:	$75,000 per loss per occurrence
	Coverage:	$125,000 excess of retention including loss adjustment expenses.
	Reinsurance Premium:	4% of the business covered. Deposit premium $4,200.
5.	Type of Coverage:	Class D/E Stop Loss
	Lines Reinsured:	All Property Business
	Company's retention:	Annual aggregate net losses up to 100% of the Company's net premiums written.
	Coverage:	100% of the annual aggregate net losses in excess of the retention, including LAE.
	Reinsurance Premium:	The net premiums written multiplied by the sum of the eight years' losses incurred divided by the total of the net premiums written for the same period, multiplied by the factor of 100/80ths. Minimum rate of 7% of NPW and a maximum rate of 25%. Deposit premium of $7,200.

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2001. Any adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Washington Town Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2001

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash Deposited in Checking Account	$ 10,875	$	$	$ 10,875
Cash Deposited at Interest	816,141			816,141
Stocks or Mutual Fund Investments (at Market)	126,026			126,026
Mortgage Loans on Real Estate	534,769			534,769
Real Estate (Net of Accumulated Depreciation and Encumbrances)	43,267			43,267
Premiums and Agents' Balances In Course of Collection	14,035			14,035
Premiums, Agents' Balances, and Installments Booked but Deferred and Not Yet Due	2,711			2,711
Investment Income Due or Accrued		9,452		9,452
Fire Dues Recoverable	204			204
Other Assets: Reinsurance Contingent Commission Receivable	6,153			6,153
Furniture and Fixtures	3,573		3,573	
TOTALS	$1,557,754	$9,452	$ 3,573	$ 1,563,633

Liabilities and Surplus

Net Unpaid Losses	$ 3,000
Unpaid Loss Adjustment Expenses	100
Unearned Premiums	50,018
Reinsurance Payable	2,289
Amounts Withheld for the Account of Others	287
Payroll Taxes Payable	200
Other Liabilities:	
Expense Related	
Accounts Payable	2,900
Nonexpense Related	
Premiums Paid in Advance	3,280
TOTAL LIABILITIES	62,074
Policyholders' Surplus	1,501,559
TOTAL	$ 1,563,633

Washington Town Mutual Insurance Company
Statement of Operations
For the Year 2001

Net Premiums and Assessments Earned	$ 72,698
Deduct:	
Net Losses Incurred	5,170
Net Loss Adjustment Expenses Incurred	8,395
Other Underwriting Expenses Incurred	54,412
Total Losses and Expenses Incurred	67,977
Net Underwriting Gain	4,721
Net Investment Income:	
Net Investment Income Earned	79,537
Net Realized Capital Gains	0
Total Investment Income	79,537
Net Income	$ 84,258

Washington Town Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2001

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	1997	**1998**	**1999**	**2000**	**2001**
Surplus, beginning of year	$1,155,988	$1,229,847	$1,306,515	$1,338,448	$1,422,348
Net income	74,146	72,679	37,408	76,137	84,258
Net unrealized capital gains or (losses)	(713)	3,989	(1,357)	6,733	(4,562)
Change in non-admitted assets	426	0	(4,118)	1,030	(485)
Surplus, end of year	$1,229,847	$1,306,515	$1,338,448	$1,422,348	$1,501,559

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2001 is accepted.

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Conflict of Interest—It is recommended that the company ensure that conflict of interest statements are filled out for all directors every year, even those directors who take over during the interim.

   Action—Compliance.

2. Conflict of Interest—It was suggested to the company that the conflict of interest statements be filled out at the organizational meeting following the annual meeting.

   Action—Compliance.

3. Claims Adjusting—It is recommended that the company establish procedures by which the adjusting committee is formally appointed on a yearly basis in accordance with s. 612.13 (4), Wis. Stat.

   Action—Compliance.

4. Claims Adjusting—It is suggested that the company appoint the adjusting committee and any other standing committees of the board at the organizational meeting following the annual meeting.

   Action—Compliance.

5. Disaster Recovery Plan—It is recommended that the company document in writing, and periodically re-evaluate, its disaster recovery plan.

   Action—Compliance.

6. Notes Receivable—It is recommended that the company properly report its investment in Policyholders Mutual Insurance Company as an asset not admitted on all future annual statements.

   Action—No longer applies.

7. Mortgage Loans on Real Estate—It is recommended that the company require that all applications for mortgage loans be signed by the potential mortgagor.

   Action—Compliance.

8. Book Value of Real Estate—It is recommended that the company formalize its agreement with the preschool; this agreement should include, but is not limited to, a requirement that adequate liability insurance be maintained by either the company or the preschool; and the company should ensure that the annual rent be paid.

   Action—Compliance.

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent current period. A review of minutes of the board of directors meetings did not always indicate approval of all purchases and sales for investments, including renewal of certificate of deposits. A treasurer's report was often approved, but this was not kept with the minutes and also did not show investment transactions. It is recommended that the board of director's minutes indicate approval of individual investment transactions of the company, and that the minutes should include copies of any reports presented to the board.

A review of the company's bylaws noted that sub-section 4 states that the Secretary shall have general management of the company. The board split the duties of Secretary and Treasurer January 3, 2001. Currently the Manager of the company is the Treasurer. It is recommended that the by-laws be amended to show that the Treasurer has general management of the company. Amendments to by-laws are not effective until they are filed with and approved by the commissioner as required by s. 612.04, Wis. Stat. A review of minutes of the board of directors noted that the President often did not vote on motions at the board of directors meetings. The board has passed a resolution since the examination fieldwork allowing the president to vote, so he is not an ex-officio member.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has not executed formal written agreements with its agents. The company's only agent is a director and treasurer/manager of the company, and is not paid a commission.

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination. It was noted that the manager is also employed by an insurance agency, and writes insurance policies on types of business that the company does not write such as auto insurance and flood insurance.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity Bond	$ 100,000
Professional Liability	2,000,000
Worker's Compensation	Wisconsin statutory
Employers Liability	
Bodily injury by accident	100,000
Bodily injury by disease in aggregate	500,000
Bodily injury by disease per employee	100,000
Commercial General Liability	
General aggregate	2,000,000
Products - completed operations aggregate	2,000,000
Personal and advertising limits	1,000,000
Each occurrence	1,000,000
Medical expense limit - any one person	5,000
Damage to rented premises – any one premises	100,000
Property	
Office building	166,700
Personal property	40,000

The company issued a policy to insure its home office building and its contents.

Underwriting

The company has a written underwriting guide. The guide covers business that the company is presently writing. However, the guide is not complete on all the company's underwriting standards. For example, there are certain types of businesses or properties that the company does not write or where the company will not write, which are not identified in the underwriting guide. Also, the company does not have a formal inspection procedure for both new and renewal business, whereby a sampling of new applications and of renewal business is inspected. However, the company has been reviewing properties to update coverage. The company makes sure that at least one director knows each property, and the company's overall claim experience has been very favorable. It is recommended that the company maintain an underwriting guide that is complete, and establish a formal inspection procedure for new and renewal business.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is not in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is not maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

The company does use its computer for recording cash receipts. However, a cash receipts journal is not maintained in accordance with s. Ins 13.05 (3) (b), Wis. Adm. Code. The company recorded cash receipts showing the date the policyholder's check was deposited in the bank, not the date the check was received by the company. It is recommended that the company record the date of receipt, not the date of deposit, in its cash receipts journal in compliance with s. Ins 13.05 (3) (b), Wis. Adm. Code.

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. When a payment was made related to a claim, a mortgage loan, or reinsurance, the original cancelled check was attached to a document in those files. It is recommended that the company maintain all cancelled checks filed in one location. This will assist with improved record keeping. Copies of the cancelled checks could be placed in the claim, mortgage loan, reinsurance, etc., files. The verification of assets and determination of liabilities were made as of December 31, 2001.

The company's accounting system books premium when it is billed, rather than on the effective date of the policy. Premiums for the first three months of 2002 were billed and booked in December 2001. The company did not retain the detailed records that supported its December 31, 2001 computation of balances for Unearned Premium Reserve, Advance Billed Premiums, Premiums in Course of Collection, and Deferred Installments Receivable. Examiners reviewed company records prepared in February and March 2002 to review the December 2001 balances; because of the way the computer system is designed the February and March 2002 reports could not duplicate the December 2001 reports precisely. Therefore examiners could not recalculate the company's year-end balances exactly, however company balances were accepted for examination purposes. It is recommended that the company retain all records related to each year's financial statements, pursuant to s. Ins 6.80, Wis. Adm. Code. .

The company is not audited annually by an outside public accounting firm, as it is exempt from this requirement under s. Ins 16.02 (3) (d), Wis Adm. Code. However, a public accounting firm prepares the annual statement and does year end accounting for the company.

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. Access to the computer is currently limited to the company's Manager/Treasurer. Thus the lack of limiting access presently did not appear to be a problem. There is a part-time person who could be granted access to the computer. It was discussed with company personnel that consideration be given to establishing procedures to limit access under a new computer system.

Company personnel backs up the computer at least every two weeks and monthly the backed-up data is kept off-site. A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

The company has been having computer and system problems the last two years. The company has not been able to produce reliable and accurate reports. As a result of the problems, the company is in the process of obtaining a new computer and is studying two vendors for new or updated software.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company developed a written disaster recovery plan in compliance with a recommendation in the prior examination report. The company's disaster recovery plan appears to be adequate.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

> (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
>
> (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company was not in compliance with these requirements as mutual funds were being reported with the brokerage firm as owner. The company was not aware that in November 2001 the mutual funds were transferred with the brokerage firm named as owner. During the course of the examination the broker was contacted, and the mutual funds were returned back to the name of the company. It is recommended that the company be in compliance with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets.

Investment Rule Compliance

The investment rule for town mutuals allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$362,074
2.	Liabilities plus 33% of gross premiums written	111,338
3.	Liabilities plus 50% of net premiums written	98,275
4.	Amount required (greater of 1, 2, or 3)	362,074
5.	Amount of Type 1 investments as of 12/31/2001	874,225
6.	Excess	$512,151

The company has sufficient Type 1 investments.

The investment rule prescribes that a town mutual shall divest any investment which does not comply with the rule within three years of its noncompliance, unless the Commissioner permits a longer period or requires a shorter period. Currently the company has no investments which are not in compliance with the new investment rule, with the mutual funds having been listed under the company's name as described above.

ASSETS

Cash and Invested Cash **$827,016**

The above asset is comprised of the following types of cash items:

Cash in company's office	$ 0
Cash deposited in banks-checking accounts	10,875
Cash deposited in banks at interest	816,141
Total	$827,016

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in one bank. Verification of the checking account balance was made by obtaining confirmations directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of 13 deposits in 11 depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2001 totaled $54,955 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 4.01% to 6.85%. Accrued interest on cash deposits totaled $7,512 at year-end.

Stocks and Mutual Fund Investments **$126,026**

The above asset consists of the aggregate market value of $27,773 in stocks and $98,253 in mutual funds held by the company as of December 31, 2001. Mutual funds were held by a brokerage firm, as noted previously. Stock owned by the company was located in the company safety deposit box.

Stock certificates were physically examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2001 on stocks and mutual funds amounted to $4,004 and were traced to cash receipts records. There were no accrued dividends at December 31, 2001.

Mortgage Loans on Real Estate **$534,769**

The company's investment in loans on real estate consisted of twelve loans having aggregate unpaid balances totaling $534,769 as of December 31, 2001. Investments in mortgage loans were within the limitations prescribed by the Wisconsin Statutes and the rules of the Commissioner of Insurance. A mortgage loan is limited to 2/3 of the fair market value per s. Ins. 6.20 (5)(c), Wis. Adm. Code. This office has limited investments in mortgage loans to 50% of total assets, and required certified appraisals for new loans. However, the company may request a waiver in writing for an appraisal on an individual loan when a mortgage loan is refinanced.

Required legal records and documents were reviewed for all loans made during the examination period. Mortgage loan records contained appraisals or other documentation on properties securing loans. Records containing evidence that adequate hazard insurance was maintained on mortgaged property and that current property taxes had been paid were reviewed by the examiners. The mortgage loans outstanding as of year-end were at an interest rate of 7.5%. During the current year, interest received amounted to $28,134 and interest due and accrued at year-end totaled $1,940.

Book Value of Real Estate **$43,267**

The above amount represents the company's investment in real estate as of December 31, 2001. The company's real estate holdings consisted of land, building, and improvements. The local preschool uses the basement of the office building for its activities for an annual fee of $1. There is a written lease agreement with the preschool. The preschool carries, at its expense, liability and fire and contents insurance with the town mutual listed as an additional insured.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

Agents' Balances or Uncollected Premiums **$14,035**

The above ledger asset represents the amounts due from policyholders which are not in excess of 90 days past due at year-end. Individual policyholders accounts were reviewed. As noted previously, this account included premiums billed in December for the first three months of 2002. The computer-generated direct bill receivable of $18,272 was reduced by the company by $4,237 for advanced billed premium. The company did not retain the detailed records that supported December 31, 2001 amounts. Therefore examiners could not recalculate the company's year-end balances exactly. The company's balance was accepted for examination purposes. See the recommendation in Accounts and Records for retention of year-end records.

Premium, Agents' Balances, and Installments Booked But Deferred and Not Yet Due **$2,711**

The above ledger asset represent premiums which are receivable from policyholders but which are not yet due as the policyholder has chosen a semiannual or quarterly billing mode. The company calculates this amount by using modal premium information. A review of the procedure used to estimate this amount determined that because January-March 2002 billings were done in December the correct year-end deferred installment amounts were not used. Therefore examiners could not recalculate the year-end balances exactly. The company's balance was accepted for examination purposes. See the recommendation in Accounts and Records for retention of year-end records.

Investment Income Due and Accrued **$9,452**

Interest due and accrued on the various assets of the company at December 31, 2001, consists of the following:

Cash at interest	$7,512
Mortgage loans	1,940

The amounts were verified by tracing to subsequent cash receipts.

Fire Dues Recoverable **$204**

This asset represents fire department dues receivable at December 31, 2001. The examiners reviewed the company's fire department dues calculation and found the asset to be correct. The actual amounts paid were verified to cash disbursement records. The overpayment was applied to the quarterly installment due April 15, 2002.

Reinsurance Contingent Commission Receivable $6,153

This asset represents the contingent commission receivable by the company as of December 31, 2001. It is from the Class B – First Surplus section of its reinsurance contract with Wisconsin Reinsurance Corporation. A review of year-end accountings with the reinsurer and verification of subsequent receipt of the amount verified the accuracy of this amount.

Equipment, Furniture, and Supplies $0

This asset consists of $3,573 net book value of furniture and equipment owned by the company at December 31, 2001. In accordance with annual statement requirements, this amount has been deducted as an asset not admitted.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$3,000**

This liability represents losses incurred on or prior to December 31, 2001, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	$3,000	$4,000	$(1,000)
Less:			
Reinsurance Recoverable on Unpaid Losses	0	3,080	(3,080)
Net Unpaid Losses	$3,000	$ 920	$2,080

The examiners developed this liability by totaling an estimated amount for those 2001 and prior losses remaining unpaid at the examination date. There were no loss payments made through the development period on those losses incurred on or prior to December 31, 2001. The examiners' development shows a redundancy of $2,080. Since the company's estimate was conservative and the difference is not considered material, surplus is not adjusted for the difference noted in the examination report.

The annual statement included $3,000 for IBNR claims and $0 for unpaid reported claims. The examiners' review noted four reported claims open at year-end, and no IBNR claims. Also, the company did not have documentation on how the IBNR estimate was arrived at. It is recommended that the company properly report unpaid reported claims in Schedule J-1 of the annual statement, and that the company document how it developed the IBNR estimate.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A complete loss register is maintained when the manual, the electronic, and reinsurance liability loss registers are used.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.

3. Proofs of loss were properly signed.

Unpaid Loss Adjustment Expenses **$100**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2001, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability was reviewed. The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Unearned Premiums **$50,018**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology. This method was approved by the Office of the Commissioner of Insurance January 2, 1991.

As noted earlier in this report, the company did not retain the record of unearned premium reserves that was generated at year-end. A report of the gross unearned premium given to the examiners was run March 12, 2002; it had a difference of $9,117 from the year-end report used by the company to prepare the annual statement. The examiners accepted the annual statement amount for purposes of this examination report. See the recommendation in Accounts and Records for retention of year-end records.

Reinsurance Payable **$2,289**

This liability consists of amounts due to the company's reinsurer at December 31, 2001, relating to transactions which occurred on or prior to that date. The actual amount paid, net of commissions, was $1,989. The difference of $300 was not considered material for purposes of this examination, and surplus is not adjusted for the difference. Cash disbursement records and reinsurance accountings verified the amount of this liability.

Amounts Withheld for the Account of Others **$287**

This liability represents employee payroll deductions in the possession of the company at December 31, 2001. The company was not able to provide supporting records and subsequent cash disbursements to verify this amount, as noted below.

Payroll Taxes Payable **$200**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2001, which had not yet been paid. Payroll records and cash disbursements were reviewed. The company could not provide documentation on how the annual statement amounts for this liability and for Amounts Withheld were determined. It is recommended that the company maintain records to support amounts reported on the annual statement for payroll taxes payable, and amounts withheld for account of others.

Accounts Payable **$2,900**

This liability represents the company's estimate for unpaid general expenses at December 31, 2001. Supporting records and subsequent cash disbursements verified items and that the liability was reasonable.

Premiums Paid in Advance **$3,280**

This liability represents premiums paid by policyholders in advance of the due date. Supporting policy and cash receipt records verified the accuracy of this balance.

V. CONCLUSION

Washington Town Mutual Insurance Company is a unique company in that it writes only on Washington Island and nearby Detroit Island. The company insures approximately 70% of the year-round residents. The company has shown consistent increases in admitted assets and surplus over the past five years since the last examination, with surplus increasing 30%. However, policies in force decreased 6.6% over the past five years.

The loss ratio has historically been low, averaging 23.2% over the past five years. The low loss ratio can be attributed to conservative underwriting practices, knowledge of the policyholder, and limited amounts of losses.

This examination of the company resulted in nine recommendations. The recommendations were for better documentation and control, and for retention of year-end records that would help improve the operations of the company,.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 15 – Corporate Records—It is recommended that the board of director's minutes indicate approval of individual investment transactions of the company, and that the minutes should include copies of any reports presented to the board.

2. Page 15 – Corporate Records—It is recommended that the by-laws be amended to show that the Treasurer has general management of the company.

3. Page 17 – Underwriting—It is recommended that the company maintain an underwriting guide that is complete, and establish a formal inspection procedure for new and renewal business.

4. Page 17 – Accounts and Records—It is recommended that the company record the date of receipt, not the date of deposit, in its cash receipts journal in compliance with s. Ins 13.05 (3) (b), Wis. Adm. Code.

5. Page 18 – Accounts and Records—It is recommended that the company maintain all cancelled checks filed in one location.

6. Page 18 – Accounts and Records—It is recommended that the company retain all records related to each year's financial statements, pursuant to s. Ins 6.80, Wis. Adm. Code.

7. Page 20 – Invested Assets—It is recommended that the company be in compliance with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets.

8. Page 25 – Net Unpaid Losses—It is recommended that the company properly report unpaid reported claims in Schedule J-1 of the annual statement, and that the company document how it developed the IBNR estimate.

9. Page 27 – Payroll Taxes Payable—It is recommended that the company maintain records to support amounts reported on the annual statement for payroll taxes payable, and amounts withheld for account of others.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Bridgot Quandt of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

Andrew M. Fell
Examiner-in-Charge